Loon

Loon

Loon Energy Inc. 1999 Annual Report

Corporate Profile

Loon Energy Inc. is a publicly traded energy company engaged in exploring for, developing and producing crude oil and natural gas in Western Canada. The Company owns interests in six producing properties as well as reserves and undeveloped mineral rights in Central and Southern Alberta and West Central Saskatchewan. Loon commenced activity as an oil and gas company in August 1997. The common shares of Loon are listed for trading on the Canadian Venture Exchange (symbol: LEY). At year-end 1999, there were 14,231,124 common shares outstanding.

The annual and special general meeting of Loon Energy Inc. will be held at 3:00 p.m. on May 23, 2000 in the McDougall Room at The 400 Club, 710 – 4th Avenue S.W., Calgary, Alberta.

Table of Contents

Abbreviations

°API	Degrees API; gravity or density of liquid petroleum products defined by the American Petroleum Institute
ARTC	Alberta Royalty Tax Credit
bbl	Barrel
BOPD	Barrels of oil per day
BOE	Barrels of oil-equivalent
MSTB	Thousands of stock tank barrels
Mcf	Thousand cubic feet
Mcfe	Mcf-equivalent
MMcf	Million cubic feet
Bcf	Billion cubic feet
NGL's	Natural gas liquids

1 barrel of oil = 0.15891 cubic metres
1 Mcf of gas = 28.17399 cubic metres
Volumes converted from gas to oil-equivalence (BOE) at 10 Mcf per bbl

President's Message

We are pleased to present our results for 1999, a year in which the Company strengthened its financial position and broadened its production and reserve base.

Loon's achievements during 1999 included the following:

- **Increased production from 43 BOE/d (100% oil) in the first quarter to 90 BOE/d (57% gas, 43% oil and NGL's) in the fourth quarter**
- **Increased operating income from $28,403 in the first quarter to $102,960 in the fourth quarter**
- **Increased cash flow from $17,352 in the first quarter to $79,611 in the fourth quarter**
- **Participated in drilling 7 wells, 4 of which were Company-operated, with a 71% success rate (3 gas, 2 oil and 2 dry)**
- **Added five new producing properties**
- **Drilled the first Company-operated well – a successful gas well at Carvel**
- **Commenced gas production at Strachan on the 1998 deep gas discovery**
- **Drilled a significant heavy oil discovery at Silverdale, Saskatchewan, with further development drilling planned**
- **Added to the inventory of prospects and undeveloped land base**
- **Welcomed a Chief Geologist to the Company**
- **Became operator in three producing properties, with contract field personnel**
- **Completed two private placement financings**
- **Recorded the first positive earnings ($0.01 per share in the third quarter)**

Subsequent to year-end, Loon commenced production from its two heavy oil discoveries in Saskatchewan - Silverdale and Epping. Loon now has six producing properties: Grand Forks, Silverdale and Epping (oil); and Carvel, Strachan and Warwick (gas). The Company began the year with one producing property (Grand Forks), and added five new properties through drilling. Loon operates three of the new properties, Silverdale, Epping and Carvel. The Company's production base is now much more stable, in terms of geographical area, commodity, decline profile and netback. The Company has growth opportunities in most of its producing properties as well as in its prospect areas as described later.

In the fourth quarter of 1999, Loon's production base was 43% weighted to oil and NGL's, and the new oil production at Silverdale and Epping in the first quarter of 2000 will increase that percentage.

As a result of its improved financial situation, the Company is now in a position to make minor property acquisitions where price levels are reasonable and a strategic fit exists. However, Loon remains focused on creating its own opportunities through internal drilling prospects.

President's Message

The major reason for the recent success is adherence to our corporate strategy, detailed below:

Loon Energy's Corporate Strategy

- Increase cash flow by exploration, development and acquisition of oil and gas properties.
- Focus on areas with shallow- to medium-depth drilling, multi-zone potential, existing infrastructure and year-round access: Central/Southern Alberta, Western Saskatchewan.
- Develop and maintain an inventory of internally-generated prospects.
- Farm-out a portion of the internal prospects to realize additional value and limit risk.
- Acquire properties that can be exploited through further drilling and recompletion projects and through production optimization. Target motivated companies.
- Negotiate seismic options at little or no up-front cost to the Company.
- Negotiate farm-ins on reasonable terms.
- Acquire Crown and freehold land where costs are reasonable.
- Maintain an appropriate "risk-reward" balance.
- Limit exposure on any single drilling project and concentrate on near term cash flow.
- Maintain an appropriate balance between gas, light oil and heavy oil.
- Operate properties where possible and practical.
- Minimize administration costs and maintain focus.

Loon maintained its general and administrative (G&A) expenses at a low level through the year and expects to further reduce costs on a per-BOE basis in 2000. The increased production levels and corporate activity are still being managed by the same staff levels as a year ago, which means that more of the operating income will translate directly into cash flow. The Company continues to be run very efficiently and effectively, with its management assisted by experienced, part-time consultants in the areas of accounting, land, geophysical, drilling, facilities engineering and financial management. This allows the Company to minimize G&A costs, which in turn helps it to weather any storms and remain responsive to new corporate opportunities and changing industry conditions.

Corporately, there were a few changes in personnel. In May 1999, Jeff Boissonneault resigned as Vice President, Exploration. He did not stand for re-election as director at the 1999 annual general meeting. The Company wishes to thank Mr. Boissonneault for his efforts in developing Loon's exploration strategy during the startup phase. Tom Field was appointed Chief Executive Officer of the Company on April 1, 1999, to add to his responsibilities as President and

Director. In July 1999, the Company welcomed Dave Slessor as Chief Geologist. Mr. Slessor will focus on developing Loon's existing lands and adding new prospects. Bob Hobbs resigned as director effective January 1, 2000, to concentrate on other interests. Loon thanks Mr. Hobbs for his valuable guidance during the past 2 1/2 years.

Outlook for Loon in 2000

Fundamentals in the Canadian oil and gas industry improved dramatically in mid 1999, following a very difficult 18 months. In the first quarter of 2000, the industry experienced the strongest combined commodity prices in 15 years. However, equity markets, particularly for junior resource companies, have remained very weak during this recovery. Share prices of virtually all oil and gas companies have been depressed and there is very little investor interest in equity offerings. These circumstances dictate that companies must live within their cash flow and show internal growth. Fortunately, that requirement fits well with Loon's strategy as the Company has internal prospects to develop and expects to grow primarily through the drill bit.

Loon enjoyed a very solid second half in 1999. We are confident that Loon will continue to show consistent, profitable year-over-year growth and become a strong junior producer. The preceding year, even with its incredible change in industry conditions, has illustrated Loon's adaptability. Continued growth is expected through 2000 as the Company builds on this momentum.

In closing, I would like to acknowledge the advice and support of our directors and the loyalty of our shareholders.

On behalf of the Board of Directors,

THField

Thomas H. Field, P. Eng.
President and Chief Executive Officer
April 10, 2000

Operations Review

Five new producing areas were added during the year, four of them directly resulting from Loon's internal prospects and one (Strachan) from a farm-in that was part of Loon's original business plan in 1997. The Company's production base is much more stable, and further steps will be taken in 2000 in that regard.

Areas of Activity

Grand Forks

The Grand Forks property continued to yield solid cash flow in 1999, even during the low oil price environment early in the year. This was due to continued low operating costs, low decline rates (now less than 15%/year) and the benefits of ARTC. The property averaged 40 bbls/d oil for 1999. The average oil price was $21.95/bbl, combined operating costs and royalties were $7.45/bbl and the netback was $14.50/bbl. With the increase in the price for this medium-gravity crude to $30/bbl, netbacks more than tripled through the year, increasing from $5.50 to $18.00/bbl. Loon holds an average 21.5% working interest in the property, which is located approximately 50 miles west of Medicine Hat. The ten producing Glauconitic oil wells are primarily on 40-acre spacing, and the Company believes additional drilling would be economically viable. However, a facility expansion would be required and the operator is reviewing the feasibility of the project.

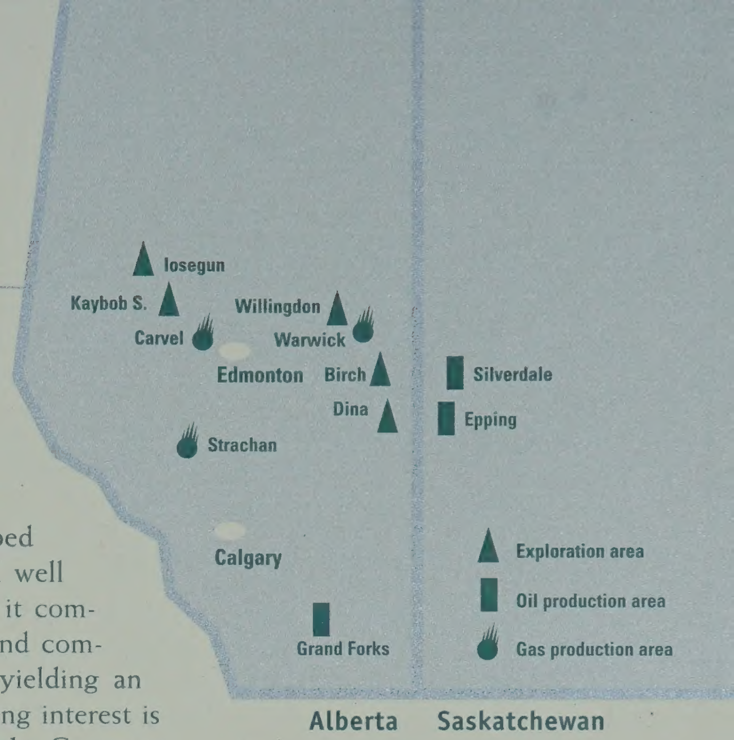
Strachan

In October 1999, the Strachan discovery well (Loon 10% before-, 5% after-payout) commenced production. The 2-22 well, a 1998 Swan Hills gas discovery, has essentially performed as predicted by the well test analysis, declining to 3.7 MMcf/d (240 Mcf/d sales gas net to Loon) by early February 2000. At that time, the operator identified a mechanical problem in the wellbore and the well was shut in for extensive repairs. The well is expected to resume production in April. Average net sales gas production at Strachan from the period of production was 360 Mcf/d plus associated sulphur, with an operating netback of $0.71/Mcf. The Strachan property holds tremendous potential from a large land base totaling 8,000 gross acres. Production in the area is derived from many different zones, and further drilling on these lands is contemplated for 2000. The partners in the lands are reviewing drilling possibilities and Loon may farm out its interest on future wells, depending on capital allocation and Loon's interpretation of the hydrocarbon potential and risk. A new well to access probable uphole reserves identified in the 2-22 well has been deferred by all partners pending further Swan Hills gas production from the 2-22 well. This second well may now be drilled to target the deeper Swan Hills & Leduc formations as well as those shallower zones.

Carvel

Loon's Carvel 3-33 well, the Company's first operated well, was drilled in January/February 1999, and encountered gas pay in two separate Mannville zones. The 3-33 well commenced production in April 1999. Drilling was based on one of Loon's prospects. Loon farmed out its original 33.34%

Operations Review



interest to earn a 16.67% interest, and the well was drilled and cased at no cost to the Company. Up to March 2000, only one zone could be produced at a time due to plant limitations. That situation has now changed and the Company has equipped the well for dual production. Net production from the Carvel well averaged 270 Mcfe/d (including NGL's) from the period after it commenced production. The average gas price was $3.03/Mcfe and combined royalties and operating expenses totalled $1.00/Mcfe, yielding an operating netback of $2.03/Mcfe, or $20.30/BOE. Loon's working interest is 16.67% in section 33 and three additional sections operated by the Company. In December 1999, Loon drilled a well to test the pool extension, but unfortunately it was dry and abandoned. Loon also has a 12.5% non-operated interest in one additional section of land at Carvel; a well was drilled on this land in December 1999 and cased as a potential gas well. The operator is currently reviewing tie-in economics. Development possibilities still exist on the remaining lands, but drilling will be deferred in favour of lower risk projects elsewhere.

Warwick/Willingdon/Birch

At Warwick, Loon drilled a successful gas well in mid 1999 on an internal prospect. The well was completed in the Camrose and commenced production in October. In keeping with its business strategy, Loon farmed out its 50% interest such that it paid only 15% of drilling and completion costs to earn a 25% working interest. Although the Camrose flow test analysis was very encouraging, the well began producing large amounts of associated water shortly after commencing production. The Camrose was suspended and the Viking zone completed and brought on production. Production from the Viking has been lower than expected, with rates currently below 100 Mcf/d. Although the first well has been disappointing, Loon's capital exposure was low and the project demonstrates the benefits of the Company's strategy. Loon plans to pursue its other prospects in the Warwick/Willingdon/Birch area. New seismic shot on the Birch prospect, 15 miles southeast of Warwick, helped to identify a prospect and a well is planned for later in 2000. Loon's interest at Birch is 20%. Loon also has a prospect at Willingdon, 12 miles northeast of Warwick. Due to prioritization of projects, there are no near-term plans to drill on the Willingdon lands, which do not expire for three years. This East Central Alberta Gas project area is attractive to Loon for its low drilling costs, multi-zone potential and infrastructure.

Dina

Loon shot seismic and identified an oil prospect on its Dina lands in East Central Alberta. The Company farmed out the prospect in late 1998 to preserve capital, and the farmee drilled and completed a Sparky oil well at no cost to Loon. The well commenced production and despite a follow-up stimulation, has marginal productivity and will likely be abandoned. At Dina

North, Loon has a 10% gross overriding royalty in one section on which an oil prospect was identified. Loon farmed out its 50% original interest to hold a 10% royalty, and the farmee expects to drill a well in mid 2000.

Forty Mile Coulee

Loon participated for 16% in a well targeting Sunburst gas at Forty Mile Coulee, 45 miles southwest of Medicine Hat in southern Alberta. The well, drilled in December 1999, was dry and abandoned, and Loon earned an interest in 3 sections of land. The seismic indicates potential for further drilling locations on the lands, but there are no present plans.

Silverdale

In December 1999, drilling on Loon's Silverdale prospect, 5 miles south of Lloydminster, yielded a significant heavy oil discovery. The C2-12 well commenced production in February 2000 and is presently averaging 60 BOPD of 15 °API oil (30 BOPD net to Loon's 50% interest). A follow-up well is planned for mid-year and, if successful, could identify several more locations. The lands are approved for 10 acre spacing and Loon's interest, purchased at a Crown land sale, covers 160 acres.

Epping

At Epping, 25 miles south of Lloydminster, Loon drilled another one of its heavy oil prospects in December. The A16-14 well (Loon 50%) also encountered Sparky oil and commenced production in February 2000. Initial production rates averaged only 10 BOPD (5 BOPD net). The well has undergone a workover to improve production and it is hoped a sustained rate of 20 BOPD can be achieved. Loon also operates the Epping property.

Kaybob South, Iosegun

Kaybob and Iosegun, both in northwest Alberta, are third-party prospects in which Loon has the option to participate for a 20% working interest in drilling to earn a 20% working interest before payout and 10% after payout. Kaybob is a Devonian Blueridge gas prospect, with the potential for 3 Bcf of liquids-rich gas, while Iosegun is a Triassic oil prospect, with potential for 500 MSTB. Access to both areas is limited to winter and therefore drilling would not occur before 2001. Loon expects to participate in at least one of these two prospects.

Utikuma

Loon participated for 20% in the purchase of three separate quarter sections at a Crown land sale in October 1999. Loon plans to drill a well in 2001 or 2002. Utikuma, approximately 230 miles northwest of Edmonton, is an oil-prone area.

Management's Discussion and Analysis

The following discussion and analysis is a review of Loon's historical financial and operating results and should be read in conjunction with the audited consolidated financial statements and accompanying notes.

Highlights

- Cash flow for the year ended December 31, 1999 increased to $235,522 compared to a cash flow deficiency of ($78,192) for 1998
- Production increased to 90 BOE/d by December
- Positive earnings of $83,322 were recorded
- Netbacks increased to $15.33/BOE in 1999 from $8.34/BOE in 1998
- Five new production areas were added, with Loon operating three of those properties
- New discoveries were made at Carvel, Warwick, Silverdale and Epping
- Net land holdings increased by 6% to 2,812 acres (20,280 acres gross)
- Two private placement financings were completed, raising $502,000

Revenues

Petroleum and natural gas revenues before royalties, for the year ended December 31, 1999 were $613,486, a 204% increase compared to $201,715 for the year ended 1998. This increase resulted from new production from Carvel, Strachan and Warwick. Production volumes for 1999 increased to an average of 66 BOE/d from 53 BOE/d for the nine months of production in 1998. Of the five new producing properties, two commenced production after year-end, and two commenced production in the fourth quarter, minimizing their impact on annual production averages. The December 1999 production rate was 90 BOE/d. In 1999, Loon's product mix was 63% oil and NGL's and 37% gas, compared to 100% oil in 1998, as all three new properties in 1999 contributed gas. The average prices received in 1999 were $23.21/bbl oil, $21.76/bbl NGL's and $2.88/Mcf gas.

Royalties

Total royalties as a percentage of gross income increased to 9.0% in 1999 from 5.4% in 1998 as a result of freehold royalties at Carvel which do not qualify for ARTC and increased product prices resulting in higher Crown royalty rates. Royalty expenses increased to $55,342 from $10,733 due to increased revenues. The ARTC earned for 1999 was $16,837 compared to $7,100 for 1998. This increase was a result of higher eligible production volumes. The Company expects a credit on its Crown royalty payments for the Strachan production pending royalty holiday approval.

Production Expenses and Operating Netbacks

Operating costs and royalties (net of ARTC and processing income) were $9.96/BOE, an increase from the $5.47/BOE recorded in 1998, when all of Loon's production was ARTC-eligible. The resulting netback was $15.33/BOE, compared to $8.34/BOE in 1998. This netback is expected to continue to improve for 2000 due to higher average oil prices, partially offset by natural production declines.

Production Volumes	Annual	Daily Avg
Oil & NGL's (bbl)	15,213	41.6
Gas (Mcf)	90,421	24.7
Total (BOE)	24,255	66.3

Netback ($/BOE)	
Sales price	25.29
Royalties	2.28
Operating Expenses	7.68
Operating Netback	15.33

General and Administrative Expenses

General and administrative (G&A) expenses, net of capitalized overhead and operator recoveries, decreased to $89,955 ($3.71/BOE) in 1999 from $158,163 ($10.88/BOE) in 1998. The figures for 1998 were unusually high due to the additional full-time staff member in 1998 and certain "one-time" startup costs, primarily related to legal services. Total G&A expenses are not expected to increase materially in 2000. More importantly, it is expected that expenses on a unit (per-BOE) basis will decrease significantly for 2000 with increased production volumes.

Interest Expenses

Net interest expenses for 1999 totaled $46,420 compared with $42,251 in 1998.

Depletion, Depreciation and Site Restoration

Depletion and depreciation decreased in 1999 as a result of increased reserves from additions at Carvel, Warwick, Silverdale and Epping. Total depletion and depreciation was $149,500 in 1999 compared to $279,000 in 1998. On a unit of production basis, depletion and depreciation decreased to $6.16/BOE.

Income and Capital Taxes

All current income taxes have been deferred using the Company's accumulated tax pools and capital losses from predecessor companies. As shown in the following table, Loon had $4,713,000 of tax pools at December 31, 1999.

	Balance at Dec 31, 1999 ($)
Canadian Exploration Expense	55,000
Canadian Development Expense	7,000
Canadian Oil & Gas Property Expense	1,743,000
Undepreciated Capital Costs	370,000
Capital Losses	1,491,000
Non-Capital Losses	813,000
Share Issue Expenses	234,000
	4,713,000

The Company did not pay capital taxes in 1999, but will do so in 2000 with production from its Saskatchewan properties, which are liable for the Saskatchewan Resource Surcharge.

Management's Discussion and Analysis

Net Income and Cash Flow

Operating income was $371,897, a 204% improvement from $122,222 recorded in 1998. Cash flow for the year increased to $235,522, or $0.02 per share, compared to a cash flow deficiency of ($78,192), or ($0.01) per share, for the year ended December 31, 1998. Net income amounted to $83,322, or $0.01 per share, in 1999, compared to a net loss of ($363,792), or ($0.05) per share, in 1998.

Capital Expenditures

For the year ended December 31, 1999, Loon's capital expenditures amounted to $575,278, compared to $1,956,738 for 1998. The capital expenditures for 1998 were higher due to the amount for the acquisition of the Grand Forks oil property and approximately $769,000 in drilling expenditures at Strachan, Pine Creek and Windfall.

Liquidity and Capital Resources

Loon finances its operations from three sources: internally-generated cash flow, equity issues and debt financing. Cash flow for the year ended December 31, 1999 totaled $235,522, a substantial improvement from the cash flow deficiency of ($78,192) in 1998. The Company had a working capital deficiency of $735,015 at December 31, 1999, primarily due to accruals from its December 1999 drilling program and the application of excess cash against Loon's credit facility. Loon had a $400,000 revolving credit line of which there was zero drawn as of December 31, 1999 due to the Company's cash position. In November 1999, the Company's banker revised the credit facility, converting it to a demand revolving facility without fixed repayment terms. A $300,000 demand debenture is held by TUSK Energy Inc. Two private placement financings were completed in 1999 resulting in a total cash influx of $502,000. These funds were utilized to finance drilling at Carvel, Forty Mile, Epping and Silverdale, and for general working capital purposes. A total of 2,400,000 flow-through and 2,200,000 ordinary common shares were issued in these financings, resulting in 14,231,124 shares outstanding at year-end. Loon's year-end closing share price was $0.14. Subsequent to year-end, Loon issued a total of 239,584 common shares, primarily related to the exercise of purchase warrants, and now has 14,470,708 common shares issued and outstanding. On November 29, 1999, the Company's shares commenced trading on the Canadian Venture Exchange ("CDNX") following the amalgamation of the Alberta and Vancouver Stock Exchanges.

Business Risks

As an oil and natural gas explorer, developer and producer, Loon faces certain inherent risks and uncertainties that have the potential to significantly affect operating and financial results. These risks are operational and financial in nature. Operational risks relate to the ability to economically find, develop and produce reserves. The Company minimizes that risk by using skilled, experienced and motivated staff, by adhering to its business strategy (including managing risk in its portfolio of capital projects) and by controlling costs. Other forms of operational risk that Loon deals with are: competition, access to pipelines, access to markets, government regulations, damage to equipment and environmental impacts. The Company's insurance program and compliance with safety and environment legislation also mitigate operational risk. Financial risks relate to commodity prices, exchange rates, access to capital and interest rates. Loon attempts to maintain a balanced product mix to mitigate commodity price risk.

Management's Report on Responsibility

The consolidated financial statements are the responsibility of the management of Loon Energy Inc. They have been prepared in accordance with generally accepted accounting principles, using management's best estimates and judgements, where appropriate.

Management is responsible for the reliability of the consolidated financial statements, the notes to the consolidated financial statements, and other financial information contained in this report. In the preparation of these statements, estimates are sometimes necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgements and have been properly reflected in the accompanying financial statements.

Management is also responsible for maintaining a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable information.

The board of directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The board is assisted in exercising its responsibilities through the audit committee of the board, which includes three non-management directors. The audit committee meets periodically with management and the auditors to satisfy approval of the financial statements to the board.

Ramsay, Dalton & Co., the independent auditors appointed by the shareholders, have audited the Company's consolidated financial statements in accordance with generally accepted auditing standards and their report follows. The independent auditors have full and unrestricted access to the audit committee to discuss their audit and their related findings as to the integrity of the financial reporting process.

TH Field

Thomas H. Field, P. Eng.
President and Chief Executive Officer

Auditors' Report to Shareholders

To the Shareholders of Loon Energy Inc.
We have audited the consolidated balance sheets of Loon Energy Inc. as at December 31, 1999 and 1998 and the consolidated statements of operations, deficit and cash flow for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and the disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999 and 1998 and the results of its operations and the changes in its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

Ramsay, Dalton & Co

Ramsay, Dalton & Co.,
Chartered Accountants,
March 15, 2000, Calgary, Alberta

Loon Energy Inc.
Consolidated Balance Sheets

As at December 31	1999	1998
Assets		
Current Assets		
Cash	$ 309,086	$ 5,615
Accounts Receivable	158,478	42,049
Prepaids and Deposits	17,538	9,437
	485,102	57,101
Capital Assets (Note 3)	1,561,875	1,316,097
	2,046,977	1,373,198
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts Payable	920,117	349,484
Current Portion of Long-Term Debt	300,000	60,000
	1,220,117	409,484
Future Site Restoration	9,300	6,600
Long-Term Debt (Note 4)	-	420,000
Debentures (Note 5)	-	75,000
Shareholders' Equity (Note 6)		
Share Capital	1,098,030	825,906
Deficit	(280,470)	(363,792)
	817,560	462,114
	$ 2,046,977	$ 1,373,198

See Accompanying Notes

APPROVED BY THE BOARD

Norman W. Holton, Director

Thomas H. Field, Director

Loon Energy Inc.
Consolidated Statements of Operation

For the years ended December 31	1999	1998
Oil and Gas Revenues, Net	$ 558,142	$ 197,372
Expenses		
Operating Costs	186,245	75,150
Depletion and Depreciation	149,500	279,000
Provision for Future Site Restoration	2,700	6,600
General and Administrative	89,955	158,163
Interest on Long-Term Debt	46,420	42,251
	474,820	561,164
Income (Loss) from operations	$ 83,322	$ (363,792)
Income (loss) per share	$ 0.01	$ (0.05)

See Accompanying Notes

Consolidated Statements of Deficit

For the years ended December 31	1999	1998
Deficit, beginning of year	$ (363,792)	$ (1,222,026)
Reduction of Stated Capital (Note 6)	-	1,222,026
Net (loss) income	83,322	(363,792)
Deficit, end of year	$ (280,470)	$ (363,792)

See Accompanying Notes

Loon Energy Inc.
Consolidated Statements of Cash Flow

For the years ended December 31	1999	1998
Operations		
Income (Loss)	$ 83,322	$ (363,792)
Add items not affecting cash		
Provision for Future Site Restoration	2,700	6,600
Depletion and Depreciation	149,500	279,000
Funds from Operations	235,522	(78,192)
Change in Non-Cash Working Capital	446,103	261,428
	681,625	183,236
Financing		
Long-Term Debt	(180,000)	480,000
Debentures	(75,000)	-
Issue of Share Capital in Settlement of Debt	27,000	-
Issue of Share Capital for Cash	502,000	743,125
Share Issue Expenses	(76,876)	(34,098)
	197,124	1,189,027
Investing		
Capital Assets	(575,278)	(1,956,738)
	(575,278)	(1,956,738)
Increase (decrease) in cash	303,471	(584,475)
Cash, Beginning of Year	5,615	590,090
Cash, End of Year	$ 309,086	$ 5,615
Funds from Operations per Share	$ 0.02	$ (0.01)

See Accompanying Notes

Notes to Consolidated Financial Statements

1. Future Operations The Company began operations as an oil and gas company in August 1997. The recovery of oil and gas property costs capitalized and the repayment of creditors is dependent on the Company's ability to continue to generate profitable operations and on the continued cooperation of major creditors.

2. Significant Accounting Policies The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

(a) Principles of consolidation The financial statements consolidate the accounts of the Company and its wholly owned subsidiaries, Trident Creative Technology Inc. and Zama Energy Ltd.

(b) Oil and Gas Properties The Company follows the full cost method of accounting in accordance with the guidelines issued by the Canadian Institute of Chartered Accountants, whereby all costs associated with the exploration for and development of oil and gas reserves are capitalized. All such costs are accumulated in one cost centre representing the Company's activities undertaken in Canada. Such costs include land acquisitions, drilling and geological and geophysical expenses related to exploration and development activities. Gains or losses are not recognized upon disposition of oil and gas properties unless crediting the proceeds against accumulated costs would result in a significant change in the rate of depletion.

Costs capitalized in the cost centres are depleted using the unit-of-production method, based on estimated proven oil and gas reserves, before royalties. For purposes of the depletion calculation, oil and gas reserves are converted to a common unit of measure on the basis of their relative heating value. The carrying value of undeveloped properties is excluded in the depletion calculation.

In applying the full cost method, the Company performs a ceiling test which limits the capitalized costs less accumulated depletion and depreciation to an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves, based on year-end prices and costs, and after deducting estimated future general and administrative expenses, future abandonment and site restoration costs, financing costs and income taxes.

The Company periodically reviews the costs associated with undeveloped properties to determine whether the costs will be recoverable. An impairment allowance is made if the results of the review indicate an impairment has occurred.

Estimated future site restoration costs are provided for using the unit-of-production method based upon estimated proven reserves. Costs are estimated by the Company based upon current regulations, costs, technology and industry standards. Removal and site restoration expenditures will be charged to the accumulated provision as incurred.

(c) Joint Ventures Substantially all of the Company's oil and gas activities are conducted jointly with others. The accounts reflect only the Company's proportionate interest in such activities.

(d) Flow-Through Shares The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and share capital are reduced by the estimated cost of the renounced tax deductions when the expenditures are incurred.

(e) Measurement Uncertainty The amounts recorded for depletion and depreciation of capital assets and the provision for future abandonment and site restoration costs are based on estimates. The ceiling test is based on such factors as estimated proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future periods is uncertain.

(f) Deferred Income Taxes The Company follows the deferral method of accounting for income taxes under which the provision for corporate income taxes is based on the earnings reported in the accounts and takes into account the tax effects of timing differences between financial statement income and taxable income, except as explained in Note 7.

(g) Per Share Amounts Per share amounts have been calculated using the weighted average number of common shares outstanding during the year. Assuming the exercise of stock options and share purchase warrants, there would be no dilution in income (loss) per share.

(h) Comparative Figures Certain comparative figures have been reclassified to conform with the current financial statement basis of presentation.

(i) Stock Options The Company has a stock option plan as described in Note 6. When stock options are issued the value of the options is not determined or recorded. Any consideration received on the exercise of stock options is credited to share capital.

(j) Financial Instruments The carrying values of accounts receivable and accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of the instruments. Long-term debt bears interest at floating rates and therefore the carrying value approximates its fair value.

3. Capital Assets

December 31, 1999	Cost	Accumulated Depletion & Depreciation	Net Book Value
Oil and Gas Properties	$ 2,039,018	$ 483,000	$ 1,556,018
Office Equipment	11,357	5,500	5,857
	$ 2,050,375	$ 488,500	$ 1,561,875

Notes to Consolidated Financial Statements

December 31, 1998	Cost	Accumulated Depletion & Depreciation	Net Book Value
Oil and Gas Properties	$ 1,643,740	$ 336,000	$ 1,307,740
Office Equipment	1,357	3,000	8,357
	$ 1,655,097	$ 339,000	$ 1,316,097

During the year administrative overhead expenditures of $75,000 (1998 - $154,000) directly related to the acquisition, exploration and development of petroleum and natural gas reserves have been capitalized. No interest has been capitalized to oil and gas properties in either of the years ended December 31, 1999 or 1998. The depletion calculation has excluded unproved properties of $63,000 (1998 - $113,000).

As at December 31, 1999, the estimated future site restoration costs to be accrued over the remaining proved reserves are $30,000 (1998 - $31,000).

4. Long-Term Debt

	December 31, 1999	December 31, 1998
Bank Loan	$ -	$ 180,000
Promissory Note	300,000	300,000
Balance	300,000	480,000
Less: Current portion	(300,000)	(60,000)
	$ -	$ 420,000

(a) Pursuant to a financing arrangement with a Canadian financial institution, the Company has a $400,000 revolving demand loan secured by a $2.5 million fixed and floating charge debenture and a general assignment of principal operating agreements, production receivables and contracts associated with the properties of the Company.

(b) The Promissory Note bears interest at the bank's Prime Rate plus 1 percent and is subordinated to the bank loan. The holder, TUSK Energy Inc., is a shareholder of the Company.

5. Debentures The debentures payable were repaid in December, 1999. They bore interest at 12% per annum and were secured by a general security agreement covering all assets of the Company.

6. Share Capital

(a) Authorized share capital: Unlimited number of common shares. Unlimited number of preferred shares

(b) Issued: Common shares and Special Warrants were issued as follows:

	December 31, 1999 Number	December 31, 1999 Amount ($)	December 31, 1998 Number	December 31, 1998 Amount ($)
Common Shares:				
Balance Beginning of Year	8,387,624	363,993	3,442,874	1,033,747
Issued for Cash:				
Issuance of Common Shares	2,200,000	220,000	-	-
Issuance of Flow-Through Common Shares	2,400,000	282,000	1,000,000	150,000
Exercise of Special Warrants	1,093,500	461,913	3,944,750	792,158
Issued for Settlement of Debt	150,000	27,000	-	-
Less: Tax Effect of Flow-Through Shares	-	(180,000)	-	(373,000)
	14,231,124	1,174,906	8,387,624	1,602,905
Less: Reduction of Stated Capital	-	-	-	(1,222,026)
Share Issue Expenses	-	(76,876)	-	(16,886)
Balance End of Year	14,231,124	1,098,030	8,387,624	363,993
Special Warrants:				
Private Placement Class C Flow-Through Special Warrants	-	-	927,500	510,125
Private Placement Class D Special Warrants	-	-	166,000	83,000
	-	-	1,093,500	593,125
Less: Share Issue Expenses	-	-	-	(17,212)
Tax Effect of Flow-Through Shares	-	-	-	(114,000)
	-	-	1,093,500	461,913
Total Capital Stock and Common Share Equivalents	14,231,124	1,098,030	9,481,124	825,906

The common shares of the Company were consolidated on the basis of four shares of Trident Systems Inc. for one share of Loon Energy Inc. effective August 18, 1997.

c) Pursuant to an Escrow Agreement effective March 2, 1998 among the Corporation, Montreal Trust Company of Canada, TUSK Energy Inc. ("TUSK") and Norman W. Holton, 345,155 Common Shares owned by TUSK and 573,084 Common Shares owned by Mr. Holton are subject to escrow. All such shares will be automatically released from escrow, on an equal basis, on each of the first, second and third anniversaries of the date of the agreement. A total of 306,079 shares remain in escrow at December 31, 1999.

(d) Stock Options

A summary of the status of the Company's stock option plan as of December 31, 1999 and 1998, and changes during the years ending on those dates presented below.

	1999		1998	
	Options	Weighted Average Exercise Price ($)	Options	Weighted Average Exercise Price ($)
Outstanding at Beginning of Year	740,000	0.26	740,000	0.26
Granted	1,000,000	0.15	-	-
Exercised	-	-	-	-
Expired/Cancelled	(465,000)	0.36	-	-
Outstanding and Exercisable at End of Year	1,275,000	0.14	740,000	0.26

The following table summarizes information regarding stock options outstanding at December 31, 1999:

Options Outstanding

Exercise Prices ($)	Number Outstanding	Weighted Average Remaining Contractual Life
0.10	275,000	2.6
0.15	1,000,000	4.9
	1,275,000	4.4

(e) Share Purchase Warrants At December 31, 1999 there were 187,500 share purchase warrants outstanding which allows the holder to acquire 187,500 shares at a minimum price of $0.10 a share within two years of the Company's shares being listed for trading. On March 17, 2000 the warrants were exercised by the holders.

(f) Reduction of Share Capital At the annual shareholders meeting held June 25, 1998, the shareholders of the Company adopted a special resolution to reduce the stated capital of the Common Shares by $1,222,026 and, as a result, the deficit of the Company was reduced by the same amount.

7. Income Taxes The company and its subsidiaries have non-capital losses of approximately $813,000 which can be used for the reduction of future years' taxable incomes and have been carried forward for income tax purposes. These non-capital losses expire as follows:

2000 -	$378,000
2001-	61,000
2002-	99,000
2003 -	11,000
2004 -	191,000
2005 -	$72,000

In addition, the Company has net undeducted tax pools of approximately $2,500,000 that could be deducted from future taxable income.

At December 31, 1999 share capital and oil and gas properties have been reduced by $730,000 as the estimated cost of renounced income tax deductions.

No recognition has been made in the accounts for possible reduction of income taxes in future years resulting from these tax losses and tax pools.

8. Commitments

a) At December 31, 1999 the Company had a commitment to incur and renounce a further $282,000 of tax attributes associated with exploratory and development activities.

Corporate Information

Directors

Edwin A. Beaman, P. Eng.
Vice President, Engineering
TUSK Energy Inc.

Ian T. Brown, P. Geol.
Vice President
Gadsby Energy Ltd.

Thomas H. Field, P. Eng.
President and Chief Executive Officer
Loon Energy Inc.

Kenneth R. Heuchert, P. Eng.
Businessman

Norman W. Holton, P. Geol., Chairman of the Board
President and Chief Executive Officer
TUSK Energy Inc.

Officers

Thomas H. Field, P. Eng.
President and Chief Executive Officer

Norman W. Holton, P. Geol.
Chairman

Brian W. Mainwaring
Secretary

Corporate Information

Corporate Offices
Suite 1950, 700 - 4th Avenue SW
Calgary, Alberta T2P 3J4
Phone: (403) 264-8877
Fax: (403) 263-4247

Stock Exchange Listing
Canadian Venture Exchange
Symbol: LEY

Wholly Owned Subsidiaries
Trident Creative Technology Inc.
Zama Energy Ltd.

Auditors
Ramsay, Dalton & Co.
Calgary, Alberta

Bankers
National Bank of Canada
Calgary, Alberta

Solicitors
Gowling, Strathy and Henderson
Calgary, Alberta

Registrar and Transfer Agent
Montreal Trust Company of Canada
Calgary, Alberta

Loon

Loon Energy Inc.

1950, 700 - 4th Avenue S.W.
Calgary, Alberta, Canada T2P 3J4

Printed in Canada